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International Accounting: Prices In A Planned Economy

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EDITOR'S NOTE: This column is not a book review, but a summary. Until this book is published in English, a highly unlikely event, it will remain inaccessible to accountants and economists who speak neither Russian nor German. This column is designed to help them in their research.

International Accounting

Prices In A Planned Economy

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Since prices, especially of food items, are the major cause of the developments in Poland, a closer look at the Russian system of price formation should be of interest to everybody in the West. And since prices play a crucial role in the determination of net income, the subject is of special concern to accountants.

To describe the Russian system of price determination this column will summarize a recent book by Professor Dr. Juri W. Jakowez. The Russian title of the book is *Zeny w planowom chosjaistwe;* a German translation under the title *Die Preise in der Planwirtschaft,* published in East Germany (Verlag Die Wirtschaft, Berlin, 1976, 246 p.), is the basis for this column since the author of this column does not speak Russian. All page references are to the German edition. The Engligh translation of the title is *Prices in a Planned Economy*.

A note about the translation from the German of the book into the English of this column is in order first of all. The German book is written in academese, which is similar to bureaucratese, a style noted for unnecessarily long words and sentences, for superfluous repetitions and a generally murky language. In addition, the official literature of socialist counties — and a book about price formation certainly belongs into that category — is written not only to describe and explain its subject, but also to justify and glorify the Communist way as the best of all possible ways. To make this column easier to read and understand, the German version will generally be paraphrased and the propaganda will mainly be eliminated. Whenever it is necessary to be precise or to emphasize a point, an exact translation, identified by quotation marks, will be used.

The book consists of an introduction, a main body of seven chapters, and a summary. This cclumn will follow that format. The titles of the chapters will be used as section headings.

In his introduction Jakowez states that past research in the "science of planned price formation" (p. 15) has focused on a description and explanation of the status quo. In his opinion, the decisions of the 24th Congress of the Communist Party to stabilize the price level and, wherever economically feasible, to lower prices necessitates a new examination of price development. No doubt the worldwide inflation of the past decades and its effect on the socialist economies played a part, too. In any event, Jakowez sees a need for an "exhaustive examination of the nature and factors of price movement in the socialist economy, as well as the development of a scientifically based mechanism for the planned management of price development" (p. 16) and promises to fill that need with his book.

Planned Prices as a Concept in the Socialist Economy

According to Jakowez the planned price is a new concept in economics peculiar to socialist countries. It has two functions: On the one hand it expresses the value of the costs of production, just as it does in other countries; on the other hand it is a tool of socialist planning and a lever in the state's management of the economy.

Jakowez realizes that the development of the economy cannot be planned unless prices, too, are planned. In addition to prices, he writes, the state also uses such other statistics as "the volume of finished production, profits, profitability, costs of production and transportation, the money income of the population, the volume of investments, etc." (p. 21) in planning the socialist economy. He acknowledges that every one of these variables is dependent on prices when he writes, a few pages later, that "prices determine the volume of finished production and of profits, the level of profitability, the real income of the workers, the proportional distribution of the national income as well as the stability of the money supply." (p. 27) What he does not discuss, in this or any other chapter, are the problems caused in the planning process by the interdependencies of the planning and planned variables.

Instead, he discusses the Marxist value concept, i.e. the idea that the labor incorporated in a product determines its value, ending with the prediction that money, prices, and value determinations, will disappear as soon as Communism rules the world. However, he adds, "this will only happen in the distant future; until then it is necessary to study the nature and causes of price formation and price movement." (p. 24)

The second half of the chapter describes the methods used to set prices and pricing policies. The price level, for instance, is determined by the Council of Ministers of the USSR; the prices for the most important industrial goods are set by the central government departments; locally determined prices are coordinated by the price committee of the Council of Ministers.

Of more interest here are some of the remarks relating to accounting. For example, enerprises can sell below planned prices if there is no demand for their products. This action will, understandably, reduce their net income; however, their planned payments to the government — a euphemism for income taxes — are not affected. (p. 34) Executives can lose the bonuses they get for the realization of the firm's net income if their suggestions for industrial or consumer prices deliberately overestimated production costs. And Kosygin himself warned firms at the 24th Party Congress that "all attempts to realize profits by ignoring or increasing planned prices or by disregarding planned product lines or manufacturing standards constitute an action against the interests of the state." (p. 37)

Nature and Trends of Price Movements

Jakowez starts this chapter by referring to the great Soviet price statistician (his description) S. G. Stoljarow who found that prices increase and decrease slowly over long periods of time, but that they seldom, if ever, return to their original levels. Staljarow concludes that prices increase all the time and will continue to do so as long as prices exist. (p. 44) This conclusion causes Jakowez to wonder whether price movements are subject to some economic law which makes inflation inevitable.

To prove or disprove the existence of such an economic law he lists the factors causing reductions in costs and, through them, in prices, such as increases in labor productivity, scientific and technological progress, and specialization. In his opinion these tendencies towards lower prices are sometimes offset by wage increases in excess of increases in labor productivity. As an example he cites higher wages for workers in collective farms which increased costs and wholesale prices for agricultural products in the early 1970s.

Jakowez then describes price movements in the West over the past 200 years. He, like British and American economists before him, finds a steady increase in the price level. He dismisses the wage-price spiral as a cause of inflation because, in his opinion, Marx disproved that theory when he showed that wage demands follow price increases. Jakowez also thinks that, in general, labor productivity in the capitalistic countries increases faster than wages and cites Wygodski as proof. Wygodski, he says, examined wages and prices in the US between 1945 and 1967 and found that labor productivity increased by 98.7 percent, wages increased by 32 percent, prices of industrial goods rose by 89 percent and some monopolistic prices rose by as much as 15 percent. (p. 50)

Jakowez then examines the role of money in Western inflation. He finds that increases in the paper money supply and the abandonment of the gold standard were contributing factors, but he concludes that monopolies and monopolistic pricing policies, not some immutable economic law, are the basic causes of inflation in the West.

He then turns his attention to price movements in the Soviet sphere of influence. He summarizes prices, pricing decisions and the reasons for them from Lenin to the early 1970s and finds here, too, a general upward trend. He lists four reasons for inflation in Russia:

1. Increases in wholesale prices due to increases in wages, decreases in working hours, and increases in costs in the extractive industries caused by the mining of marginal properties;

2. Elimination of losses in some industrial branches to facilitate better planning and economic stimulation and to create the basis necessary for effective accounting systems;

3. Increases in the income of collective and state-owned farms to increase their profitability and their proportionate share of national income; and

4. Increases due to the chain reaction of other increases. (pp. 63-64)

Jakowez remarks that price increases affected mostly wholesale prices and that retail prices remained generally stable, "a considerable achievement of the economic policy of the Party and the state," in his words. (p. 64) He also notes that this policy caused losses to the state on important consumer goods like meat, butter, and potatoes, when wholesale price increases were not offset by corresponding changes in retail prices and these goods were, in effect, sold below cost. Apparently prices were raised for some consumer goods, because Jakowez blames the increases in the prices of meat, butter, potatoes, and vegetables for the decrease in the real income of some people, especially people with fixed incomes, and for the decline in the purchasing power of the ruble.

He concludes that the past increases in the price level in Russia were not due to some general law of economics but caused by "measures necessary to create the prerequisites for higher efficiency of socialist production and lower production costs and the subsequent return to the main direction of the long-term pricing policy of a general, economically founded, lowering of the price level." (p. 64)

For the future Jakowez sees the main purpose of Soviet price planning in maintaining the stability of the price level and in lowering individual prices as seen as economically feasible. (p. 67)

Long-Term Price Planning

In this chapter Jakowez first examines the problem of whether price planning should take place before or after economic plans are drawn up. He concludes that the two are so interwoven that price and economic planning must proceed simultaneously. He then lists the following goals for long-term price planning:

1. to price goods and services to reflect the absolute and relative amount of labor contained in them and to gradually lower the price level;

2. to enhance the role of prices in the acceleration of scientific and *technical progress, in the improvement of product quality, and in the rational usage of resources;*

3. to eliminate the current geographic differences in prices caused by differences in production costs in order to achieve uniform prices for the whole country;

4. to use the price system to spur the development and mechanization of agriculture, to lower production costs and improve the quality of agricultural products, and to narrow the existing income gap between the urban and rural population;

5. to make better use of retail prices in creating a constantly rising standard of living for the people and to lower retail prices gradually as demand is satisfied and production costs decrease;

6. to enlarge the role of prices in integrating the economies of the socialist countries, in determining comparative advantages among countries, and in furthering the effectiveness of foreign trade;

7. to strengthen the unified governmental pricing policy and to increase the effectiveness of the mechanisms for planned price formation. (pp. 82-93)

The remainder of the chapter is taken up with an exploration of the pricing systems in different segments of the economy, such as agriculture, transportation, and consumer goods.

Changes in Production Costs and Their Effect on Prices

Jakowez is aware of the interdependence of costs and prices and realizes that, in the long run, prices must cover reproduction costs. He finds two exceptions to this rule: (1) above normal costs due to specific factors, such as production below capacity by new enterprises or management mistakes, do not have to be covered by prices; and (2) some of the production costs can be covered by state subsidies or a reallocation of profits among firms in the same industry. He cites the example of the coal industry which generally operates at a loss.

He warns, however, against losses becoming a normal state of affairs. This situation "undermines the basis of effective accounting, diminishes the firm's desire to increase production and save resources, and contradicts the principles of the new system of planning and economic stimulation." (p. 122)

In Jakowez' opinion production costs are more effective in influencing wholesale than retail prices. For evidence he cites rising costs in the mining industry being followed by rising prices, and lower costs in synthetics being accompanied by lower prices. He also finds a close association between rising costs and rising wholesale prices for agricultural products. He notes that collectively-owned and state-owned farms must be reimbursed for their rising costs to insure their continued efforts to increase the production and sale of food and other agricultural products to the state.

Since retail prices, according to Jakowez, "fulfill an important social function, they are affected by factors other than changes in production costs, such as the ratio of supply to demand, the social importance of the goods or services, etc. For this reason the retail prices for important food items like meat, animal fats, milk, potatoes remain unchanged, even though the higher wholesale prices have led to a substantial increase in the state's expenses for the purchase, processing, and sale of these goods." (p. 124) Jakowez does not say what the state should do when it cannot absorb these losses any more. The former and the present Polish governments are probably very interested in the solution to that problem.

In a note of interest to accountants Jakowez states that manufacturing costs would play a larger role in setting prices if good cost accounting systems were developed which would determine the total costs and expenses and the method of allocating them over the items produced. (p. 125)

Jakowez then examines the movements of production costs for various industrial sectors and finds a mixed picture. Costs have not decreased fast enough, he thinks, for three reasons: (1) scientific and technical progress was not sufficiently supported and exploited; (2) the rate of growth of labor productivity has slowed down; and (3) rising costs in basic industries have increased costs in other sectors. To sum up Jakowez speculates in a very revealing paragraph:

"Maybe one influence on the changes in production and transporation costs has been that attention has shifted from expenses to profits and profitability in the evaluation of firms and the stimulation of the economy. Profits and profitability depend not only on changes in costs and expenses, but also on other factors, such as changes in prices and in the quality of goods produced, asset turnover, etc." (p. 132)

To end the chapter he lists four methods of lowering costs and expenses which should be emphasized in the next Five-Year Plan. They are:

1. Labor productivity must rise faster than wages. He thinks higher wages are necessary to raise the standard of living, education, and job training of the population. He also thinks the trend towards a shorter work week will continue and approvingly cites Marx who said: "The reduction in working time increases leisure time, i.e. time for the total development of the individual, which is itself the greatest production force and will affect the productive force of labor." (p. 136) (Translator's note: The German version is as murky as the English one.) Jakowez does not mention the political reasons, but then he wrote before the strikes in Poland.

2. Investments in productive assets must be increased. Since depreciation is a cash expense in Russia, i.e. a payment to the state to reimburse it for money advanced to acquire fixed assets, the amount of depreciation is available for investment. According to Jakowez depreciation expense has increased from 9.1 billion rubles in 1960 to 35.3 billion rubles in 1972; the money for investments is therefore available. Depreciation is also a small proportion of total costs and expenses, rising from 3.5 percent in 1960 to 5.4 percent in 1972. Increases in depreciation expense should therefore not have a material effect on total costs and expenses.

3. The usage of direct and indirect materials, like raw materials, supplies, and fuel, per unit of production must be reduced. Since these items constitute about three-fourth of total costs and expenses in manufacturing, small savings here can have important consequences.

4. The need to exploit less ac-

cessible natural resources and to protect the environment must be offset by the development of more sophisticated technology and machinery, especially in the extractive industries.

Profitability and Price Movements

Jakowez starts this chapter by stating that the key problem in setting and changing prices is the determination of standard profits, especially when expressed as rates of profitability. The reasons are:

1. In a socialist economy prices must be determined objectively. To plan prices, standard prices must exist, so that existing prices can be changed in their direction.

2. The most important statistics in planning and stimulating the economy are sales, the amount of net income, and the rate of profitability. These figures are directly dependent on prices.

3. Standard profits must be set before standard prices can be formulated, because standard prices should be based on costs and standard profits and not on estimates.

4. Standard profits are necessary for the planning and prediction of prices. Material differences between actual and standard profitability are signals then to check the price level in that segment or industry.

Jakowez realizes that price planning is nothing but a method of allocating total net income among segments of the economy. He warns, however, against setting one rate of profitability for the whole economy. In his opinion, different rates should be used in different industries and for different product groups to reflect the variety of conditions under which prices were set and changed in the past. But he thinks that the crucial question is: How do profits affect the movement of prices? He devotes the rest of the chapter to examining that question.

In should be pointed out here that profitability in Russian accounting is expressed as a percentage of either total costs and expenses or total productive assets, a balance sheet category similar, but not identical, to fixed assets.

Jakowez first examines trends in profitability for various segments of the economy. A table for the years 1960 through 1972 shows that profitability increased until 1970 in all sectors and then decreased in most of them. Jakowez attributes this fact less to reductions in costs and expenses and increases in labor productivity, but more to increases in industrial and wholesale prices before 1970. The table also shows differences in profitability with rates of return on productive assets ranging from 6.3 percent for state-owned farms to 19.3 percent for manufacturing, with collective farms (10.4 percent) and transportation (15.2 percent) in between. (p. 146)

When standard profits are established for the various sectors of the economy, Jakowez advocates that the following circumstances be considered:

1. The size of profits in different sectors reflects to a certain extent the value added by that sector;

2. Lower rates of return on productive assets are probable in the future due to higher investments in such assets and due to the upward revaluation of basic assets (an amount somewhat comparable to total equity) by 73 billion rubles on January 1, 1972; and

3. Higher efficiency of production should result in higher total profits which should be used for the periodic reduction of the price level for goods and services.

He concludes that differences in standard profits are appropriate for different sectors of the economy. He then examines profits within the segments of some economic sectors and arrives at the same conclusion after discussing various models for price formation.

One such model is what is known in the Soviet economic literature as the "two-channel price." This discussion throws some interesting light on the distribution of profits. The price is so named because profits are diverted into two channels: the production fund which depends apparently on the value of the productive assets, and the wages fund which seems to be based on total wages paid. The production fund is used, for instance, for transmissions to the state for the production fund tax, to the fund for production development, to lenders for interest, and into the firm's own circulating fund to increase circulating (i.e. current) assets. The wages fund is used for transmissions of profits to the fund for economic stimulation, to the fund for social and cultural activities, to the fund for residential construction, and to cover losses of municipal and housing industries. In Jakowez' opinion, "the two-channel price reflects the double role of profits in the socialist economy: On the one hand it is a source for the means of increasing production, on the other hand it is used for the economic stimulation of collective enterprises and to finance expenditures for social purposes." (p. 152)

Jakowez sides with economists who suggest a three-channel price with the third channel used for a tax on natural resources consumed and for expenditures to clean up and restore the natural environment. (Since land in Russia is not privately owned, land and natural resources are not shown as productive assets on Russian balance sheets. The costs of the extractive industries therefore consist only of the costs of extraction. The ores and minerals themselves have no cost.)

Another model for formulating prices discussed by Jakowez employes shadow prices. He describes briefly the econometric models used and then dismisses shadow prices because they cannot be substituted for "living" prices containing real values. (p. 160)

Finally he mentions, with disdain, a model in which prices are calculated to provide "internal financing." (Similarities to retained earnings are surely not accidental.) It would require higher prices in those segments in which present profits are insufficient to cover needed investments and would hinder price reductions in very profitable segments. Total internal financing of all segments would, he thinks, mean a decentralization of accumulated funds and a reduction in investments. "One advantage of the socialist planned economy," he states, "consists in the possibility to centralize accumulated funds and to use them in crucial areas. This advantage cannot be sacrificed." (p. 164)

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